Woodland Hills School District

Act 1 Tax Study Commission

A Report and Recommendation to the
Woodland Hills School District Board of Education

In accordance with Act 1 of 2006, the WHSD Act 1 Tax Study Commission (referred to herein as the TSC) was appointed by the WHSD Board of Education on September 14, 2006 and charged with the responsibilities as outlined in the Act. Those statutory responsibilities include mandatory study items as well as a formal TSC final recommendation to the Board of Education (referred to herein as the Board) regarding specific ballot questions and issues outlined in the Act.

Background

Every school board in the Commonwealth must submit at the May 2007 primary election a "back end" voter referendum question concerning adoption of a new or increased income tax. The purpose of these funds (from any new or additional income tax), if approved by the voters, is to fund property tax relief. These funds would be allocated to approved homestead and farmstead owners. The ballot question, by its nature and designed intent will cause a variety of financial impacts on both community members and the district. These impacts will vary among individuals as well as communities and school districts as a whole based on their economic and demographic situations.

A nine member TSC was duly appointed in accordance with the Act and by design, represented a wide demographic cross-section of the WHSD community. To meet the charge required for this report, the TSC met five times on advertised public meeting dates to review issues and district data. In addition, on October 16, 2006, the TSC held a public hearing to both inform the public and obtain public input.

Four mandatory study items were expressed in the statute for the TSC to review and they were as follows:

1. Historic and present district revenue from current taxes.
2. Percentage of total district revenue provided by current taxes.
3. Age, income, employment, and property use characteristics of the district tax base.
4. Projected district revenue from current taxes, and from the possible new or additional Act 1 EIT or PIT.

The TSC was provided with district and community data that met those required study items, and additional resources for information were provided beyond the scope of the statute. A copy of these materials, handouts, electronic resource information, as well the TSC meeting minutes accompany this report as an addendum for permanent Board record. All TSC resources can be accessed online at http://econ.tepper.cmu.edu/whsdtsc/

The TSC is required to make a recommendation to the Board within 90 days of Board appointment, or no later than December 14, 2006. By statute, the TSC recommendation is non-binding on the Board, and it is recognized that some data may change or be updated as the Board considers its final decision. For that reason, recommendations herein include brief and reasonable amounts of narrative to assist with Board deliberation and consideration. It is understood that the Board must act on the TSC recommendation no later than March 13, 2007, and adopt a tax referendum resolution authorizing a specific referendum question.

Recommendations

The TSC recommends the EIT tax base for the ballot question.

Since only one ballot question is allowed on the ballot, there is the necessity to choose between two options presented in Act 1 for income tax levy. The Act specifies both the earned income tax (EIT) and the personal income tax (PIT) for consideration. The TSC spent considerable time and debate over this issue. In WHSD the PIT base is about 12% larger than the EIT, simply because it taxes more items generally associated with wealth than the EIT. For taxpayers, the PIT tax base is the same as their taxable income reported on the Pennsylvania State tax return. The EIT tax base is the same as taxpayers' taxable earnings reported on the tax return for the Pennsylvania Municipal Services Corporation (PAMS).

PIT

This is the first time the State has provided school districts with the legislative authority to actually levy a PIT tax. The current State PIT rate on this base is 3.07%. The PIT is generally considered a "fairer" broader based tax in that it applies to income from assets not taxed under the EIT, specifically items such as interest earnings and dividends from certain investments. In WHSD, the differential in the two tax bases is relatively modest (12%), meaning overall it has a small impact on any tax rate that would be applied. Additionally, there was considerable debate and thought with regard to the demographics of the community. While at one end of the spectrum the PIT tax would capture wealth of those with high income and significant investments, it would also tap into those on fixed incomes, small business, farmers, and retirees who have managed to save funds other than from pensions, and draw on some investment income.

In our discussion of this issue, two major concerns became apparent. First, adoption of a PIT absent similar actions by neighboring districts in the County would create disincentives for wealthier families to move into the district, thus undermining financial support for the district. Secondly, the provisions in State tax policies allowing for various exclusions and tax credits inject a degree of uncertainty into the calculation of the property tax versus income tax trade-off that is impossible to quantify with the data we had available.

Additionally, since the PIT would be collected for the first time, initial start-up and implementation issues arise. Act 1 requires complete elimination of the current EIT tax (as currently levied by the district) should the PIT tax base be selected. There is no current tax collection structure for a school district PIT and it would have to be built, at the same time the existing EIT structure was abandoned. PIT transition would also present many problems and costs for taxpayers as they would be required to file an additional tax return (and partial fiscal year calculations) each year. The municipalities would continue to collect the EIT, and the new district PIT would be added. PAMS director Rich Lear indicated to the TSC that they could accommodate this change at an annual cost of around $10,000 for printing up the different forms and mailing them out. Even with these additional costs, we estimate that switching to a PIT would increase district revenues by about 10% (a little over $800,000).

Overall, then, while switching to a PIT would be feasible and could end up increasing district revenues overall, the problems of creating disincentives for higher income families to move into the district, and the uncertainties associated with actual collection rates persuade us that the PIT is not a good option at this point.

EIT

The EIT tax is currently levied in WHSD at a rate of 0.5% and collection structures are well established at PAMS. It is a familiar tax to constituents with regard to its association with the district, and it does not tax the interest earnings of those who manage to save funds for retirement or a rainy day. It is a given that the trade-off will be that some higher wealth individuals will benefit from not being taxed on the PIT broader base. However, as noted above, overall the TSC felt that the EIT was a better fit for the community as a whole.

The TSC recommends the rate of 1.2% for the ballot question, an increase of 0.7% over the current 0.5% EIT, used to fund the minimal reduction in property taxes in the amount of $405.

While it is not necessary to review calculations here, it is sufficient to note that Act 1 provides a statutory mandate to achieve a certain threshold of tax relief from the ballot question that raises the EIT income tax rate. It is 25% of the median homestead value as certified by the county Assessment Office. The Act also includes a cap which is 50% of the same number. The resulting numbers provide the minimum and maximum rate increase that the district may offer on the ballot question, and the range within which the TSC focused its review. As calculated on the best available data, those rates ranged from 0.7% to 1.3%. The Act includes language that restricts rate assignment rounded to the nearest tenth (for example: 0.75 or 0.95 would not be valid options).

To place the 1.2% rate in perspective, based on the 2005 data, the EIT tax would generate approximately $9.77 million. Those funds would be returned to the WHSD community dollar-for-dollar for real estate tax reductions to qualified owner occupied residential properties and farm buildings.

In deciding which rate to recommend the TSC reviewed district demographic data on age, income, renters, homeowners, and farmsteads. The committee also balanced that review with impact on the school finance operations of the district and as best as could be discerned, the overall economic implications for the community.

The Ballot Question:

Act 1 states: "The referendum question submitted to the electors of the school district at the primary election of 2007 shall state the rate of the proposed income tax to be levied, the reason for the tax, the estimated per homestead tax reduction and the current income and net profits tax levied by the school district. The question shall be clear and in language that is readily understandable by a lay person and shall be framed in one of the following forms:" [3 referendum question forms were then presented in the act].

Basically, the model questions are different based on which tax base is selected or even if the district has or does not already have an EIT tax. Based on the recommendations above, the TSC would recommend the following, which contains slightly modified wording from the standard Act language.

Referendum Question Imposing Additional EIT

"Do you favor the addition of 0.7% to the current earned income tax rate levied by the WHSD School District? The revenue generated from the increased rate will be used to reduce real estate taxes on qualified owner occupied residential properties and farm buildings by approximately $405. The current school district earned income tax rate is 0.5%."

The board should keep in mind that in making this calculation, the TSC used the number of currently registered approved homesteads and farmsteads (roughly 12,000). The county estimates that there are in fact around 18,000 eligible homesteads/farmsteads in the district. Since the district is sending out a mailing this month advising homeowners who have not registered for the exclusion to do so, the correct number to be used in the calculation will likely increase, and hence, the calculation will need to be redone just prior to the deadline for submission of referenda questions for the primary, using updated data. Finally, we note that the vote of the TSC on these recommendations was unanimous.

Pros and Cons of tax shifting

There are a number of good reasons to favor shifting support for schools away from property taxes and onto income taxes.

Property values tend to move in ways that bear little or no resemblance to local economic conditions. The housing price bubble on the two U.S. coasts probably benefited school districts there since rising assessments led to rising revenues. But, unless districts took advantage of the rising property values to cut millages, these increases in district revenue were probably a source of resentment to homeowners who faced higher mortgage payments or direct tax payments. Districts facing a negative property value bubble at a time when the local economy was growing would quickly find themselves having to raise millages substantially to keep pace, with all the consequent fallout that brings.

A second reason for shifting away from property taxes is the overall equity of the tax burden. Right now, homeowners in the district constitute 58% of total households, with the remainder being renters. But these 58% of the households pay 84% over the overall district revenues (plus whatever they pay in income taxes), while the 42% of the district households who rent pay less than 8% of the taxes supporting the schools.

In addition, the well-known problems with the assessment process are a third reason to favor shifting school taxes away from property to income.

Against these reasons favoring shifting taxes away from property toward income is a real problem that the Act 1 process itself has imposed.

Every school district in the county (with the exception of Pittsburgh) is going through the same process of specifying target reductions for property taxes and compensating EIT/PIT rate increases. Because of differences in district size, housing values, and EIT/PIT tax bases, the recommendations the school boards get are likely to vary considerably. Depending on how voters in each district choose, the county (indeed, the whole State) could end up with a patchwork quilt of different property taxes and income tax rates. These tax differences create incentives over the long run for existing residents and businesses to relocate to lower taxed districts, and for new residents and business to shop around for the best tax situation.

To see the consequences of this, consider a thought experiment whereby WHSD decides to fund the maximum property tax reduction of $810 via an EIT increase of 1.3 % (for a total combined municipal and district EIT rate of 2.3%). At the same time, our neighboring districts either opt out if voters don't approve the referenda, or opt in at minimal levels. Our district would then find itself with property taxes that give seniors, most of whom don't pay income taxes since pensions and social security aren't taxed, strong incentives to move into the district. At the same time, our high EIT rate creates incentives for working households, particularly renters, to move out. Over the long run, these combined effects will actually lower district revenues in ways that the crafters of Act 1 didn't think about or anticipate.

This consideration led the TSC to conclude that the safest course for the district was to put the minimum property tax relief option on the ballot. Voter approval of this would leave us at a combined municipal and school district EIT of 1.7%, but because of the district's size and the diversity of the EIT tax base, we can afford to fund this option at an EIT rate that is lower than what most of our neighboring districts can do.

From the perspective of the TSC, the best option would be for voters not to approve this change, and for the State Legislature to rescind Act 1 and replace it with a better thought out law that imposes uniform EIT rates across all districts, and uses the revenues generated to fund property tax relief.

Concluding Remarks

Act 1 is complex and has many "moving" parts that have yet to be settled by the courts or administrative edict. Community information and education about what Act 1 is and what it is not will be vital for voters to make an informed choice. Members of this commission had the opportunity to invest time in great detail on the subject to arrive at the recommendations included herein. It is worth noting that TSC members held thorough debates that were representative of varying perspectives and backgrounds. It is believed that our invested time, discussion, debates, and community input had significant impact on the form and fit of this recommendation. Therefore, within the guidelines as understood in Act 1, and Section 2 of the by-laws of this body, the WHSD Tax Study Commission, by submittal of this report, is of the opinion that it has discharged its duties and fulfilled all obligations. We express our appreciation to the Board and administration for their support, and to the community for their input.

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